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POSTAL RATE AND FEE CHANGES, 1997) Docket No. R97-1

Direct Testimony of

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on Behalf of

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INTRODUCTION

My name is John L. Clark. I am founder, Chairman, and Chief Executive Officer of CTC Distribution Services, L.L.C. ("CTC"). CTC began operations in 1982 in the city of Minneapolis, Minnesota. Since that time, CTC has grown to become the largest shipper of small parcels to the residences of individual consumers in the United States for the direct marketing industry.

CTC serves the direct marketing community by developing and managing distribution programs designed to deliver small parcels in a timely and cost-effective manner. Its core process is the consolidation of parcels at its nine operating hubs. This process involves the documentation, collection, sortation, and transportation of parcels to shipping facilities close to the package's final destination. Final delivery is made by a parcel delivery company.

The company's principal customers sell goods through catalogs, infomercials, home shopping networks, direct mail, and the internet, and require a cost-effective means of shipping these goods to consumers. CTC offers its clients a number of shipping alternatives, and is a user of prominent shipping companies such as the U.S. Postal Service ("Postal Service") and United Parcel Service ("UPS"), as well as local and regional carriers, for the final delivery of its shipments. CTC, therefore, is very familiar with the various competitive offerings available to small parcel shippers from leading parcel delivery companies.

During the period from 1982 through 1991, CTC relied almost exclusively on UPS for the final delivery of its shipments. After careful analysis of the Postal Service's shipping rates — particularly the destination entry discounts which became effective in 1991 — CTC began offering Postal Service delivery, as well as UPS delivery, for a final delivery option to its clients. By 1993, almost all of CTC's business had migrated to the Postal Service. CTC is a heavy user of Destination Bulk Mail Center rates, and its business has grown rapidly while utilizing DBMC entry rates.

I. PURPOSE OF TESTIMONY

The purpose of this testimony is to support, and urge the Postal Rate Commission to recommend, the Postal Service's proposals which relate to the entry of parcels at Origin Bulk Mail Centers, Destination Bulk Mail Centers ("DBMCs"), Destination Sectional Center Facilities ("DSCFs"), and Destination Delivery Units ("DDUs").

II. THE DYNAMIC MARKETPLACE

The economy of the United States has experienced a long period of growth and prosperity, with a particularly sustained surge in the 1990's. The standard of living for the average American is said to be the highest in history. Certainly, much of the credit for this prosperity must be given to our free enterprise system.

While our free enterprise system is both vast and complex, the network of transportation and distribution providers which deliver goods and services to our homes and businesses is certainly an essential ingredient. This network is an element of the economy which typically is overlooked and perhaps underappreciated because it works so efficiently. Credit for a certain degree of this efficiency can be given to the release of competitive forces which took place in 1980 with the de-regulation of trucking. Since that time, rates are no longer set by bureaus, nor are service territories limited and defined by the Interstate Commerce Commission. Freedom to enter the market and compete has resulted in more alternatives for shippers, lower costs and improved service.

Although the circumstances in this case are not identical to those involved in deregulation of the trucking industry, there are parallels between the philosophy underlying such deregulation and the thought behind the Postal Service's proposals affecting parcel post in this case. Both focus on increasing competition. Clearly, in the case of deregulation of the trucking industry, that philosophy was sound. I believe that increasing competition is also a sound philosophy with respect to parcels. This testimony will demonstrate that small parcel shippers will benefit from the increased competitiveness in the marketplace which would be created by the Postal Service's initiatives. We all need to recognize that the delivery of small parcels is one segment of our nation's economy which will benefit from more competitors. The marketplace for small parcel shipping has had too little competition. Establishing the Postal Service as a major parcel handler is good public policy.

III. THE CHANGING NATURE OF PRODUCT DISTRIBUTION

The rapidly declining cost of technology has facilitated the ability of American businesses to eliminate many costs from their operations. Application of technology to inventory management, transportation and distribution is focused under the umbrella of the science of logistics. The essential application of this science, as it relates to the matter at hand, is to achieve customer satisfaction by delivering products in a timely and cost-effective manner. This entails coordination of inventory purchase and receipt, marketing efforts, order acceptance, fulfillment, and finally, shipment to the consumer. The spreading embrace of the just-in-time inventory concept has added to a growing reliance on small parcel shipping. Competitive companies, whether large or small, can no longer afford to tie up precious capital to finance large inventory stockpiles.

In the past, product distribution involved long manufacturing times, followed by warehoused stockpiles marketed by wholesalers, and finally delivery to the consumer through a retail outlet.

Through the application of modern technology, this supply chain is undergoing significant changes. The channels of distribution are being dramatically modified to eliminate costly intermediate events between manufacturer and final user. This is most vividly demonstrated in the arena of direct marketing, a merchandising concept driven by the economical delivery of messages and product to the final user.

Did the American consumer demand the ability to shop in the convenience of his/her own home through a catalog, direct mailing or some type of other media such as a television infomercial or internet connection? And then, did industry respond with all of the sophisticated methods used today to satisfy that demand? Or was it the other way around? Did entrepreneurs develop today's modern communication, pricing and presentation concepts, and did the American consumer respond to build a dynamic direct marketing industry? While these questions could provide the basis for an interesting debate, there would be immediate agreement that neither the consumer nor the seller could be satisfied without a cost-effective method of delivering both the message and the response to the message — which is, in many cases, a small parcel containing a purchased product.

IV. THE CHANGING CHARACTER OF THE PARCEL DELIVERY NETWORK

The year 1982 does not seem to be that long ago. In that first year of CTC's operation, the nationwide single-source delivery of small parcels was limited to two choices: UPS and the Postal Service. While CTC used the Postal Service for certain specific applications, UPS was really the only cost-effective supplier of nationwide small parcel delivery. In 1982, no difference existed between residential and commercial delivery rates, and there were no discounts from published rates available from UPS to anyone.

In 1982, the revenue of Federal Express ("FedEx") was $0.8 billion; in 1996, it was $10.2 billion. Calibre Systems ("RPS") did not exist until 1985, but in 1996 produced $1.3 billion in gross revenue. Airborne Express grew from $0.3 billion to $2.5 billion during the same time period. In 1982, UPS had gross revenue of $5.2 billion, and has increased that to $22.4 billion in 1996. Comparable numbers for the Postal Service would show that the combination of Express Mail, Priority Mail and Standard B Mail grew from $1.9 billion in 1982 to $5.7 billion in 1996. The parcel post component of these numbers is $0.4 billion in 1982 and $0.7 billion in 1996. The Priority Mail component of these numbers is $0.8 billion in 1982 and $3.3 billion in 1996. Priority Mail is not under consideration for work-sharing discounts or expanded entry options in this proceeding.

It is obvious that this small parcel delivery market is dynamic and growing, and that it is not characterized by companies competing only for changes in market share. The recently-announced combination of Federal Express and Calibre Systems will make this market even more competitive. Growth of the companies mentioned above was either the result of, or the catalyst for, the demand for small parcel deliveries in a timely and cost-effective manner. I believe the "catalyst" theory. Businesses said, "If you can deliver my product more cheaply and on time, I can change the way I do business." Could one suppose that direct marketing today would be a multi-billion dollar industry without the ability to deliver small parcels cost-effectively? What would be the impact on the volume of advertising mail and catalogs if the delivery of small parcels was cost-prohibitive?

As the size of the marketplace and scope of demand for small parcel shipments expanded, carriers initially focused on specific market segments. UPS focused on ground delivery, FedEx on next-day, and RPS on business-to-business. It is said that the Postal Service thought about getting out of the parcel delivery business. In the early 1990's, carriers sought to explore expansion opportunities. The lines between carrier offerings became blurred as traditional air freight companies expanded into ground services, and ground service companies attempted next-day and second-day air freight programs. The market for which none of these carriers seemed to compete enthusiastically was residential delivery. The levy of a residential surcharge of $0.25 per parcel by UPS in 1991 was the start of a practice which placed an extra burden on companies shipping to that market. The UPS residential surcharge today is $0.80. RPS shuns residential delivery with a surcharge reported to be as high as $1.50. FedEx seems to take a targeted approach to the very highest profile direct marketers who are willing to pay premium prices.

Shipping and handling charges are a major concern for both direct marketing companies and consumers who regularly use catalogs to secure products which may not be locally available. They have a direct impact on the price and variety of merchandise which can be offered to the consumer. Shipping charges must bear some reasonable relationship to the price of the product. Thus, lower shipping charges mean lower prices for products and generally result in a wider variety of merchandise being offered to the consumer.

As mentioned earlier, the absence of a cost-effective delivery network could potentially reduce the volume of advertising mail and catalogs shipped via the Postal Service. High shipping charges would mean that only high-priced merchandise with profit ratios sufficient to absorb those charges would be offered through the mail and other media.

V. RESPONDING TO THE MARKET'S NEED

The Postal Service was wise to request the Destination Bulk Mail Center entry rate for parcels in 1990, and the Postal Rate Commission has been proven wise to recommend it. The thinking underlying this change was sound, and this single adjustment to the postal system created the opportunity for shippers to have a competitive alternative to the UPS offering, which had become very expensive for many shippers. It is worthy of mention that residential deliveries via UPS have incurred not only the surcharge, but also an annual increase in base rates over the years. For example, UPS' total charge for a three-pound parcel sent from Minneapolis, Minnesota to Atlanta, Georgia has increased from $2.53 in 1990 to $4.44 in 1997. With the availability of the Postal Service's 1991 DBMC entry rates, however, parcel post became a real option. In fact, despite a substantial rate increase for parcels entered at the DBMCs in 1995, the trend of parcel volume and revenue for the Postal Service has been positive since 1991. In addition to the DBMC entry rate, operational steps taken to enhance service have been effective in demonstrating to shippers that fourth-class (now Standard B) parcel post is efficient, reliable and provides a reasonable level of service. The product is not a premium service in that it does not provide insurance, tracking, proof of delivery or guaranteed delivery times. Shippers recognize this, and accept these competitive disadvantages in return for the lower cost afforded by the DBMC entry rates. The DBMC entry rate has made it possible to expand the price range of offerings through catalogs and advertising mail.

It is also reported that parcels entered at the DBMC rate cover their direct costs and make both a positive and significant contribution to the overhead costs of the Postal Service. The acceptance and implementation of the DBMC rate is a credit to the foresight of the Postal Service, the Postal Rate Commission, and those parties supporting the proposal in 1990. Now, the Postal Service has proposed special entry rates for Destination Sectional Center Facilities and Destination Delivery Units, as well. It is my firm belief that the recommendation of the Postal Service's proposals for DSCF and DDU parcel entry will be as beneficial as DBMC rates have been.

Obviously, new entry level rates are desirable to increase the Postal Service's business, which has very important consequences for the nation's economy. For, despite the improvements brought about by the DBMC entry rates and other parcel post improvements from 1991 to the present, UPS has remained far and away the largest parcel shipper in the country, and one upon which the country has come to depend — in my opinion, too much. It is critical that the nation have even better options than it now has for parcel delivery. Recent events tell us why.

VI. TO THE NEXT MILLENNIUM

The summer of 1997 provided all shippers, and small parcel shippers, most specifically, with a rude and unpleasant wake-up call. The strike of the Teamsters Union against UPS has been interpreted as an event which will cause a major change in the way businesses conduct their small parcel shipping practices in the future. While we have heard numerous comments concerning the danger of shippers "putting all their eggs in one basket," the most important fall-out, in my opinion, is the demonstration of the fragility of the parcel delivery mechanism upon which the nation's economy has come to depend.

August is typically a slower time of the year for small parcel shipping, and so the timing of the strike was fortunate in that some extra capacity existed in the parcel delivery system. Even under these circumstances, at the end of 15 days, all systems were at the breaking point. The pipeline was full, and the time for layoffs at those businesses depending upon alternative carriers was at hand. The strike ended just in time.

Various news articles opined that a longer strike would have resulted in $3.5 billion in lost output for the economy. As the pain mounted, a startling revelation was made by one of the trade journals: "YOU CAN'T FAX A PACKAGE."

During the course of this strike, it became painfully apparent that no substitute mechanism of sufficient capacity existed to offset the loss of UPS' network. As the strike wore on, the backlog of undelivered parcels mounted as each apparent alternative reached points beyond its capacity. On September 4, 1997, two weeks after the strike ended, the *Wall Street Journal* reported, "Now it [UPS] is coping with a huge backlog — which may have totaled 90 million parcels, according to some analysts — because many shippers held on to their freight until the strike ended."

UPS has become so dominant that, during the strike, it was reported that order response rates fell as much as 25 percent because consumers assumed that orders could not be delivered. They therefore either delayed orders or purchased the merchandise from different sources.

The UPS strike vividly demonstrates the need for an increase in the capacity of the nation's small parcel delivery network. The relevance of this is that the Postal Rate Commission is now in a position to enhance the competitiveness of an alternative to UPS: the Postal Service is in a position to provide reasonably-priced service to residential addresses. I do not believe it is sound national policy to allow one company to control over a reported 80 percent of the ground parcel shipments in this country. The aftermath of this summer's strike has given small businesses, consumers, and direct marketers a taste of what it's like to be vulnerable when a single delivery source fails.

VII. WORK-SHARING DISCOUNTS — A PROVEN CONCEPT

While I have not employed the resources to analyze, evaluate or offer alternatives regarding the quantitative and legal issues in these proceedings, it is my belief that the Commission's recommendations are ultimately tested in the field by businesses like CTC. Therefore, I feel qualified to make the following comments and observations based on the experiences of my company and the customers we serve.

Since 1979, the Postal Service has offered discounts to mailers able to organize their advertising and catalog mail in a way which promotes efficiency in delivery and avoidance of the work necessary to sort mailings into the desired sequences. Mailers, given this incentive, use computer technology to perform the sortation of names and addresses before application to the mailpiece. The logical efficiency of sorting data rather than product is self-evident. The present-day Standard A product consisted of some 26 billion pieces in 1979. For 1996, the comparable quantity is 71.8 billion pieces.

As mailpieces were produced in a sequence for delivery into the postal system, the next logical step was to avoid handling and transportation of the finished product. Thus, additional work-sharing discounts became available to mailers able to transport their products deeper into the postal system.

The absence of such a system of work sharing assisted by modern technology would probably have restricted the ability of the Postal Service and its customers to grow the direct marketing business to its current level of success, which is of benefit to the entire economy.

In order to enjoy the benefits of the Postal Service's new work-sharing proposals for parcels, shippers will need to make certain investments in facilities, hardware, and technology. To my knowledge, at present, no general capability exists to manage the large-scale documentation, collection, sortation, and transportation which will be required to maximize utilization of the proposed DSCF and DDU options. The Postal Service will also need to modify certain procedures and work out the rules required to administer the program. However, this is the same process that industry and the Postal Service went through, and continue to develop, with regard to the shipping of advertising mail and catalogs. In order to begin the work, we need a structure of rates and rules in place so that we can predict the outcome of our efforts. The Commission will hopefully approve the entry options and recommend rates which will furnish the incentive to make the needed investment and provide the Postal Service with a reasonable contribution to its overhead.

I have not undertaken sufficient study to comment on the Postal Service's justification for the proposed rate levels at the various entry points. However, it should be clear that if the rates are not attractive enough to induce shippers to route parcels into the system, the market will not respond. These rates should pass through the maximum available savings so that a powerful incentive is created to attract the up-front investment needed from private industry.

To summarize this portion of my testimony, history shows that work-sharing concepts between the Postal Service and mailers work well for advertising mail and catalogs. The same concepts logically apply to parcels as well. Parcel shippers will utilize technology and other types of investment to participate in this work sharing based on the economic tradeoffs between cost and benefit. As businesses implement solutions, the volume of parcels entered in the Postal Service will increase far beyond the present level.

VIII. GREATER CONTROL OVER SHIPMENTS AFFORDED BY NEW CONCEPTS

Like most businesses, direct marketing is exposed to certain risks. Sound management devotes significant time and effort to appraising and dealing with those risks. Measuring the results of various types of offerings can give direction to catalog offerings, pricing and inventory investments. It is my belief that the proposed destination entry concepts will enhance the direct marketer's ability to achieve a greater level of control over the distribution function of this business, and thus enjoy greater success.

Direct marketers are extremely sensitive to transit times. Consumer satisfaction is closely linked to the ability to make and keep a promise regarding delivery time. When these promises are not kept, parcel shippers are exposed to dealing with an unhappy customer as well as the threat that the consumer may not buy again.

Expansion of the Postal Service's capability to receive incoming shipments at various levels of the service — DBMC, DSCF, and DDU — would provide mailers with additional options which will provide a greater degree of control over delivery of their products.

IX. PRUDENT FINANCIAL MANAGEMENT — RESOURCE ALLOCATION

The current bulk mail center network is now 22 years old. The last bulk mail center was built in 1976. These facilities are well maintained, but are not "state of the art." Furthermore, changes in demographics across the nation and the growing markets for parcels and other mail have not always conformed to the original design of the BMC network. As a result, increasing volumes can place strains on existing facilities that can result in unacceptable variations in delivery times.

While additional investment in improving and reconfiguring the network by adding new facilities is a clear option to address this situation, the proposed parcel entry proposals for DSCFs and DDUs would contribute significantly to operational flexibility and would greatly enhance the Postal Service's policy choices in meeting the needs of mailers and the economy. In other words, the improved routing of parcels, driven by technology, can reduce the need for significant additional investment in facilities such as bulk mail centers. This will permit the Postal Service to allocate resources to other areas, and ultimately reduce the burden on all mailers. The resulting shifts in mailer choices could help the Postal Service to provide consistent, reliable service, while holding down overall costs in the long run. In this important respect, the Postal Service's proposed classification changes for

DSCF- and DDU-entry are highly desirable for both the mailers and the Postal Service, and could greatly enhance the value of parcel and other mail services to the mailing public and the American people in general.

X. COMPETITIVE CONCERNS

From time to time, I hear of concerns relating to the Postal Service as a competitor to private enterprise. Although these concerns do not focus on parcel delivery as a business segment the Postal Service should be forced to abandon, witnesses in the past have offered various proposals designed to make the Postal Service's parcel delivery option less competitive in the open marketplace.

As a shipper of small parcels to residential addresses, faced with limited alternatives and a long history of rate increases from the dominant provider, it is important to me that the Postal Service be allowed to be even more competitive in this area. Although the Postal Service benefits from a monopoly with respect to letters, no such advantage exists regarding parcels. In fact, neither the Postal Service's size, nor its financial strength, nor its nation-wide network have afforded it an effective competitive advantage over others in the market for small parcel deliveries. Far from having monopolistic power in this segment of the market, it cannot even be viewed as inhibiting the growth of other parcel delivery companies. Certainly, for example, the Postal Service has not slowed the growth or reduced the profitability of any of the leading parcel delivery companies.

It is the Postal Service's presence as a viable competitive alternative which provides a protective ceiling for its current and potential users over the unrestricted price increases of others. While residential delivery prices of the dominant provider have increased 75 percent between 1991 and 1997, users of the DBMC entry option have enjoyed relative price stability.

We are all witnesses to the lack of sufficient alternatives for parcel shippers, as demonstrated by the UPS strike this past summer. More alternatives are needed to ensure that one, single organization in this country will not control such a substantial majority of the interstate ground parcel shipments. This percentage would be even greater were it not for the DBMC entry option. Creation of additional options — such as the DSCF- and DDU-entry rates proposed by the Postal Service in this docket — will further strengthen the Postal Service as a realistic alternative for parcel shippers.

XI. CONCLUSION

Economic trends are being driven by technology which identifies and assists in eliminating inefficient processes. The Postal Service has provided studies and data which show that costs can be avoided through implementation of its proposals for the entry of parcels at destination entry points in closer proximity to the final recipient. Its judgments have proven valid with regard to DBMC-entry. They should be equally valid for DSCF- and DDU-entry.

It is competition which has helped to advance the economic prosperity we enjoy as a nation. It is the "opening up" of the capabilities of the Postal Service which, with the combined efforts of postal users and the Postal Service, will result in the efficient, safe, reliable and timely delivery of parcels. These initiatives will not cause undue harm to other competitors in this growing marketplace.

The Postal Rate Commission is now positioned to play an important role in advancing the public interest by helping the Postal Service create a parcel transportation and delivery network which is aligned with the capabilities and needs of those industries delivering products to the homes and businesses of our nation. This work is ongoing, and will not end with the initiatives being offered in this docket. Nonetheless, they are important steps in the right direction.

<u>CERTIFICATE OF SERVICE</u>

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with Section 12 of the Rules of Practice.

William J. Olson

December 30, 1997